IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 27.04.2007

CORAM:

THE HON'BLE MR.A.P.SHAH, THE CHIEF JUSTICE
and
THE HONOURABLE MRS.JUSTICE CHITRA VENKATARAMAN

W.A.No.662 of 2007

The State Bank of India
Sathy Road, Ganapathy
Coimbatore-641 006
rep. by its Executive Committee..
Appellant/1st Respondent in WP No. 41049/05

versus

1. Mr.A.K.Kandaswamy
Proprietor
Sri Ranga Industries
No.80, Athipalayam Road
Ganapathy
Coimbatore-641 006. ... Respondent./petitioner in WP NO. 41049/05

2. Asset Reconstruction Company
(India) Ltd.
17th Floor, Express Towers
Nariman Point
Mumbai-400 021
rep. by its Chief Manager... 2nd Respondent/2nd Respondent in WP NO. 41049/05

PRAYER: Writ Appeal filed under Clause 15 of the Letters Patent against the order of the learned single Judge of this Court dated 16.3.2007 made in W.P.M.P.No.44088 of 2005 in W.P.No.41049 of 2005.

Restraining the respondent and all their agents employees, servants, successors-in-interest and assignees to transfer, sell and assign the liability of the petitioner and his family held company M/s. Llaser Flow Control Pvt. Ltd along with the securities attached thereto, as stated as item nos. 11 and 12 to the Annexure to the impugned resolution dated 02.12.2005 passed by

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the Executive committee of the Central Board (ECCB) of State Bank of India under Ref, NO. 35/2005-2006 and the securities attached thereto, pending disposal of the WP NO. 41049/05

Certiorarified Mandamus to call for the records of the impugned resolution dated 2.12.2005 passed by the Executive Committee of the Central Board (ECCB)of State Bank of India under Ref. 35/2005-2006 for sale to ARCIL the financial Assets in so far ASIL relates to the petitioner M/s. Sri Ranga Industries and his family held company M/s. Llaser Flow Control Pvt. Ltd as stated item Nos. 11 and 12 to the annexure to the said resolution and to quash the same and to direct the respondent to consider the proposal dated 20.11.2005 of the petitioner.

For appellant : Mr.K.Sankaran

For 1st respondent : Mr.Sundar Muthaiah

For 2nd respondent : Mr.Murali of
M/s.Rangarajan Prabhakaran

JUDGMENT

(Judgment of the Court was delivered by CHITRA VENKATARAMAN,J.)

This writ appeal is against the order of the learned single Judge in W.P.M.P.No.44088 of 2005 in W.P.No.41049 of 2005 dated 16.3.2007, granting an order of stay in favour of the writ petitioner on the ground that there was no notice to the writ petitioner herein before the transfer and assignment of the book debt with the securities of the first respondent to the second respondent by the appellant herein, namely, the State Bank of India.

2. The writ petitioner, the first respondent herein, availed financial facility of a sum of Rs.64 lakhs in the form of term loan, working capital finance and cash credit facility from the appellant herein in the year 1982. It is stated that the first respondent was engaged in the manufacture of railway wagons and allied products. Due to various problems, the writ petitioner suffered setbacks in his business activities. It is also stated that the squeezing of credit limits by the appellant also had its impact on the functioning of the first respondent company.

3. The first respondent owed a sum of Rs.77.80 lakhs as on 27.12.1990. The liability of the writ petitioner/first

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respondent's closely held company M/s.Llaser Flow Controls Pvt. Ltd., was Rs.72.77 lakhs. The appellant instituted a civil suit in O.S.No.72 of 1991 on the file of the Sub Court, Coimbatore, on 3.2.1991 for the recovery of the amount due from the first respondent and its associate company. The said suit was transferred to the file of the Debts Recovery Tribunal, Coimbatore, in T.A.No.2038 of 2002.

4. By order dated 28.3.2001 in A.A.I.F.R. Case No.409 of 2000, the Associate Company, namely, M/s.Llaser Flow Controls Pvt. Ltd., was recommended for winding up. The assets of the said associate Company was hypothecated by way of second charge to the appellant herein. In view of the action taken by T.I.I.C. against the associate company for recovery of the amount due from it, the appellant herein took steps to delete the associate company M/s.Llaser Flow Controls Pvt. Ltd.

5. It is stated that the first respondent approached the appellant herein for a one-time settlement. Based on the discussion, the first respondent agreed to discharge its liability as well as that of the associate company, to the tune of Rs.50 lakhs. To that end, the first respondent had remitted a sum of Rs.2.50 lakhs to show their bona fides.

6. It is stated by the first respondent that in spite of the agreement, the appellant did not pass the resolution for settlement. It is further stated that the appellant herein sent a letter dated 16.8.2005, calling upon the first respondent debtor company to improve his one-time settlement of Rs.50 lakhs towards the resolution of the dispute. Accordingly, the first respondent improved his one-time settlement offer to Rs.54 lakhs as against the original offer of Rs.50 lakhs, under letters dated 5.9.2005 and 10.11.2005. When the matter stood thus, the appellant rejected the same by letter dated 18.11.2005 and returned the advance amount of Rs.2.50 lakhs to the first respondent herein. It is stated by the first respondent herein that by resolution dated 2.12.2005, passed by the Executive Committee of the Central Board of State Bank of India, under Ref.No.35/2005-2006, the appellant resolved to assign and transfer the book debt of the first respondent and the Associate company M/s.Llaser Flow Controls Pvt. Ltd. together with collateral securities attached thereto, to M/s.Asset Reconstruction Company (India) Ltd., the second respondent herein, for a sale consideration of Rs.40 lakhs.

7. The contention of the first respondent is that when they have offered to discharge their liability and that of M/s.Llaser Flow Controls Pvt. Ltd. at Rs.54 lakhs to the appellant herein, the appellant was not justified in their transferring and assigning the said liability together with the attached security to the second respondent at Rs.40 lakhs without notice and giving

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an opportunity to the first respondent to discharge his liability. The first respondent had preferred the writ petition challenging the said action, stating that when the dispute was pending before the Debts Recovery Tribunal, Coimbatore, the appellant herein had no right to assign and transfer the liability to M/s.Asset Reconstruction Company (India) Ltd., and therefore stated that as per the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, the appellant was bound to terminate the proceedings pending before the Debts Recovery Tribunal, Coimbatore, before enforcing the security. Pending consideration of the writ petition, the first respondent prayed for an injunction restraining the appellant from transferring and selling Item Nos.11 and 12 to the annexure to the impugned resolution dated 2.12.2005.

8. The stand of the first respondent was countered by the appellant herein stating that the claim of the writ petitioner that he would purchase the property at Rs.54 lakhs which would be in the interest of public was misconceived. The attitude of the first respondent was only to stop the sale. It is also stated that the sale was one in the lot and if any security is removed from the lot, it would frustrate the sale. It is also stated that the first respondent offered to settle the dues at Rs.2.0071 crores as one time settlement, but later on went back. The appellant further stated that the claim of the first respondent was mala fide. The assignment of the financial assets was done pursuant to Section 5 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, .

9. A counter affidavit was also filed on behalf of the appellant herein stating that the first respondent's right of redemption of the securities is not lost and the pending Debts Recovery Tribunal case would be continued by the second respondent herein, which would be substituted for the appellant bank in all the legal proceedings. It pointed out that the claim before the Debts Recovery Tribunal was for recovery of a sum of Rs.5,15,00,000/-; that the offer to settle at Rs.54 lakhs was only a means of compelling the appellant to settle for a sum far below the amount due. They also pointed out that for more than one and half decades, it could not recover the said sum. It is also stated that the notice of sale of the 26 financial assets were advertised. The appellant also rejected the plea that notice under Section 13(2) was not issued, as incorrect.

10. They submitted that along with the two securities of the first respondent, another 24 items of securities were notified for sale. The second respondent's offer was the highest and hence the same was in favour of the second respondent. Item Nos.11 and 12 thereof were the securities owned by the first respondent.

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11. By order dated 16.3.2007 made in W.P.M.P.No.44088 of 2005 in W.P.No.41049 of 2005, the learned single Judge noted that the first respondent was willing to pay a sum of Rs.54 lakhs and that since the assignment of the securities was made without notice to the first respondent, there was a prima facie case made out by the writ petitioner and hence, granted an order of interim stay. Aggrieved of this, the writ appeal is preferred by the appellant herein, the first respondent bank in the writ proceedings.

12. Learned counsel appearing for the appellant submitted that What has been assigned was only the book debt along with the securities in favour of the second respondent. Further, the appellant had complied with the requirements under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, by issuing notice under Section 13(2). Reiterating the contention that the two securities form part of the other assets to be sold as one basket sale, the question of giving notice again is not sustainable in law. He emphasized that Section 5 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, has an overriding provision under which the second respondent would acquire financial assets of the appellant bank. As such, the question of issuing notice did not arise. He further submitted that after the approval of the financial assets by the Assets Reconstruction Company (India) Ltd., there would not be a stay of transfer of the financial assets as per the resolution in this connection.

13. Learned counsel referred to the decision reported in 2006 (5) CTC 753 (TRANSCORE Vs. UNION OF INDIA). He submitted that given the purport of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, particularly under Section 5, the question of giving notice to the first respondent did not arise.

14. Countering the stand of the appellant herein, the first respondent stated that when it had offered to settle the liability at Rs.54 lakhs, the appellant was not justified to sell the property to the second respondent at Rs.40 lakhs. He also denied the allegation that there was no need for the bank to write to the first respondent to call for offer and that when the first respondent had made an offer of Rs.54 lakhs, the action of the appellant to sell the assets for Rs.40 lakhs was improper. It is also submitted that as per the decision reported in (2004) 4 SCC 311 (MARDIA CHEMICALS LTD. Vs. UNION OF INDIA), the appellant ought to have issued notice to the borrower on the security in question.

15. Heard learned counsel for both sides.

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16. A perusal of Section 5 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, shows that notwithstanding anything contained in any agreement or any other law for the time being in force, any securitisation company or reconstruction company may acquire financial assets of any bank or financial institution by issuing a debenture or bond or any other security in the nature of the debenture, for consideration agreed upon between such company and the bank. Section 6 provides that the bank or financial institution may, if it considers appropriate, give a notice of acquisition of financial assets by any securitisation company or reconstruction company, to the concerned obligor and any other concerned person. Where no notice of acquisition is given, monies or properties received by the financial institutions or the banks shall be held in trust for the benefit of and on behalf of the securitisation company or reconstruction company.

17. Referring to the scheme of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, NPA Act (Non-Performing Assets Act, and interpreting Sections 13(2) and 13(4), the Apex Court, in the decision reported in 2006 (5) CTC 753 (TRANSCORE Vs. UNION OF INDIA), held:

> " The NPA Act proceeds on the basis that security interest vests in the bank/FI. Sections 5 and 9 of NPA Act is also important for preservation of the value of the assets of the banks/FIs. Quick recovery of debt is important. It is the object of the DRT Act as well as NPA Act. But under NPA Act, authority is given to the banks/FIs, which is not there in the DRT Act, to assign the security interest to securitisation company/asset reconstruction company. In cases where the borrower has bought an asset with the finance of the bank/FI, the latter is treated as a lender and on assignment the securitisation company/asset reconstruction company steps into the shoes of the lender bank/FI and it can recover the lent amounts from the borrower. "

The Supreme Court held that the scheme of NPA Act gives discretion of the bank/FI to take steps to protect its assets from being alienated, transferred, disposed of in any manner.

18. Section 13 falls under Chapter III dealing with enforcement of security interest. Section 13(2) proceeds on the basis that where a borrower commits a default in payment of a secured debt and had defaulted in payment of the debt and further

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his account in the books of the bank is classified as sub-standard, doubtful or loss, the NPA Act comes into force. The Apex Court held:

> "22. ..... The scheme of sub-sections (2), (3) and (3-A) of Section 13 of NPA Act shows that the notice under Section 13(2) is not merely a show cause notice, it is a notice of demand. That notice of demand is based on the footing that the debtor is under a liability and that his account in respect of such liability has become sub-standard, doubtful or loss. The identification of debt and the classification of the account as NPA is done in accordance with the guidelines issued by RBI. Such notice of demand, therefore, constitutes an action taken under the provisions of NPA Act and such notice of demand cannot be compared to a show cause notice. In fact, because it is a notice of demand which constitutes an action, Section 13(3-A) provides for an opportunity to the borrower to make representation to the secured creditor. Section 13(2) is a condition precedent to the invocation of Section 13(4) of NPA Act by the bank/FI. Once the two conditions under Section 13(2) are fulfilled, the next step which the bank or FI is entitled to take is either to take possession of the secured assets of the borrower or to take over management of the business of the borrower or to appoint any manager to manage the secured assets or require any person, who has acquired any of the secured assets from the borrower, to pay the secured creditor towards liquidation of the secured debt.
>
> 23. Reading the scheme of Section 13(2) with Section 13(4), it is clear that the notice under Section 13(2) is not a mere show cause notice and it constitutes an action taken by the bank/FI for the purposes of the NPA Act. "

Under Section 13(2), the notice of demand which gives an opportunity under Section 13(3-A) enables the borrower to make representation/objection to the secured creditor. Hence, Section 13(2) is a condition precedent for invoking Section 13(4) of the NPA Act.

19. Further interpreting the provisions, the Supreme Court, in the aforesaid decision, held:

> " The point to be noted is that the scheme of the NPA Act does not deal with disputes between the secured creditors and the borrower. On the

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contrary, the NPA Act deals with the right of the secured creditors inter se. "

20. Referring to the scheme of the NPA Act, the Supreme Court further held that the very object of Section 13 of the NPA Act is the recovery by non-adjudicatory process. Essentially, NPA Act deals with the rights of the secured creditors.

21. Going by the Scheme of the NPA Act, all that was necessary under the Act was to give notice as contemplated under Section 13(2). Once the borrower commits a default under Section 13(4), no further notice is contemplated except as provided for under Section 6 as regards the further action of assignment and transfer of the financial institution's interest in the securities in favour of the second respondent.

Considering the protection given under Section 13(2) and in the light of the decision of the Supreme Court, as stated above, the action of the appellant could not be faulted with. In the circumstances, we uphold the contention of the appellant herein and reject the prayer of the first respondent. Consequently, we hereby set aside the order of the learned single Judge dated 16.3.2007 made in W.P.M.P.No.44088 of 2005 in W.P.No.41049 of 2005 and allow the writ appeal. There will, however, be no order as to costs. Connected M.P.No.1 of 2007 is closed.

ksv

Sd/
Asst.Registrar

/true copy/

Sub Asst.Registrar

To
The Executive Committee
State Bank of India,
Sathy Road, Ganapathy
Coimbatore 641 006

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. Asset Reconstruction Company
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+ one cc to Mr. K. Sankaran, Advocate sr o. 29347

asm(co)
nm(17.07.07)

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